AGENDA ITEM #4
February 6, 2007
Action

M E M O R A N D U M

February 2, 2007

TO: County Council

FROM: Glenn Orlin, Deputy Council Staff Director

SUBJECT: **Action—**Spending Affordability Guidelines for the FY08 Capital Budget, and other general CIP assumptions

SUMMARY OF RECOMMENDATIONS

The Management and Fiscal Policy (MFP) Committee recommendations (3-0):

- **Retain the FY07 and FY08 G.O. Bond guidelines and the FY09 G.O. Bond target at $264 million each year. Raise the FYs10-12 G.O. Bond targets to $270 million/year, raising the FY07-12 G.O. Bond guideline to $1.602 billion.** A draft resolution amending this guideline is on ©18.
- **Reduce the annual implementation rate for G.O. Bonds from 92% to 90%.**
- **Use the Executive's recommended inflation rates for now.**
- **Retain the existing PAYGO levels in FYs07-10. Increase PAYGO in FYs11-12 to $27 million/year, following the Council's policy to program PAYGO equal to at least 10% of annual G.O. Bond guidelines and targets.**
- **Reduce the revenue estimate for the Recordation Tax increment to $32 million in FY07 and to $35 million/year in FYs08-12.**
- **Reduce the revenue estimate for the School Impact Tax to $8 million/year.**
- **Reduce the revenue estimate for the Transportation Impact Tax to $8 million in FY07 and $10 million/year in FYs08-12.**
- **Continue to assume State school construction aid at $40 million/year in FYs08-12.**
- **Use the Executive's recommended Current Revenue levels for now.**
- **Confirm the current Park and Planning Bond guidelines and targets.**

The MFP Committee's proposals would change the funding available for the CIP ($ millions) as follows:

Revenue	FY07	FY08	FY09	FY10	FY11	FY12	6-Yr
G.O. SAG Implementation Rate=90%	+6.4	+6.4	+6.2	+51.4	+60.7	+59.1	+190.2
PAYGO	0.0	0.0	0.0	0.0	+5.0	+5.0	+10.0
Recordation Tax Increment	-9.5	-6.3	-7.6	-9.0	-10.7	-13.1	-56.2
School Impact Tax	-7.0	-10.0	-12.0	-15.0	-17.0	-19.0	-80.0
Transportation Impact Tax	-2.0	-3.9	-4.5	-9.4	-10.9	-13.7	-44.4
Net Change in Revenue	**-12.1**	**-13.8**	**-17.9**	**+18.0**	**+27.1**	**+18.3**	**+19.6**

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Council staff's recommendations differ from MFP's in the following ways:

- *Raise the FY07 and FY08 G.O. Bond guidelines and the FY09-12 G.O. Bond targets to $270 million each year.*
- *Raise the PAYGO levels in FY07 and FYs11-12 to $27 million/year, following the Council's policy to program PAYGO equal to at least 10% of annual G.O. Bond guidelines and targets.*
- *Reduce the revenue estimate for the Recordation Tax increment to $35 million/year.*
- *Reduce the revenue estimate for the Transportation Impact Tax to $8 million/year.*
- *Raise the assumption for State school construction aid to $50 million/year in FYs08-12.*

Council staff's proposals would change the funding available for the CIP ($ millions) as follows:

Revenue	FY07	FY08	FY09	FY10	FY11	FY12	6-Yr
G.O. SAG Implementation Rate=90%	+13.0	+13.0	+12.7	+51.4	+60.7	+59.1	+209.9
PAYGO	+0.6	0.0	0.0	0.0	+5.0	+5.0	+10.6
Recordation Tax Increment	-6.5	-6.3	-7.6	-9.0	-10.7	-13.1	-53.2
School Impact Tax	-7.0	-10.0	-12.0	-15.0	-17.0	-19.0	-80.0
Transportation Impact Tax	-2.0	-5.9	-6.5	-11.4	-12.9	-15.7	-54.4
State Aid for Schools	0.0	+10.0	+10.0	+10.0	+10.0	+10.0	+50.0
Net Change in Revenue	**-1.9**	**+0.8**	**-3.4**	**+26.0**	**+35.1**	**+26.3**	**+82.9**

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The recommendation of Councilmembers Ervin, Floreen, Knapp, and Leventhal are the same as the MFP Committee's (above), except:

- **Raise the FY07 G.O. Bond guideline to $275 million and the FY08 G.O. Bond guideline and the FY09-12 G.O. Bond targets to $280 million each year.**
- **Raise the PAYGO level in FY07 to $27.5 million and raise the PYGO levels in FYs11-12 to $28.0 million/year.**

The proposals by Councilmembers Ervin, Floreen, Knapp and Leventhal would change the funding available for the CIP ($ millions) as follows:

Revenue	FY07	FY08	FY09	FY10	FY11	FY12	6-Yr
G.O. SAG Implementation Rate=90%	+18.6	+24.1	+23.5	+62.0	+66.4	+64.7	+259.3
PAYGO	+1.1	0.0	0.0	0.0	+6.0	+6.0	+13.1
Recordation Tax Increment	-9.5	-6.3	-7.6	-9.0	-10.7	-13.1	-56.2
School Impact Tax	-7.0	-10.0	-12.0	-15.0	-17.0	-19.0	-80.0
Transportation Impact Tax	-2.0	-3.9	-4.5	-9.4	-10.9	-13.7	-44.4
Net Change in Revenue	**+1.2**	**+3.9**	**-0.6**	**+28.6**	**+33.8**	**+24.9**	**+91.8**

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The objective for this worksession is for the Council to review the Spending Affordability Guidelines for the FY07-12 CIP and the set of associated CIP assumptions. Today, February 6, is the deadline for the Council to either confirm or to amend guidelines. Any February revision is supposed to "reflect a significant change in conditions" regarding affordability, and not to take need into account. After February 6 the Council can adopt an aggregate capital budget that has expenditures that exceed the guidelines, but only with seven or more affirmative votes. The section of the County Code describing this process is on ©1-4.

I. GENERAL OBLIGATION BONDS

1. Council approved guidelines and targets. The General Obligation Bond Spending Affordability Guidelines approved for the FY07-12 CIP on February 7, 2006 were as follows:

Table 1: Spending Affordability Guidelines and Targets ($ millions)
(guidelines are in **bold**; targets are not)

	FY07	FY08	FY09	FY10	FY11	FY12	6-Year
FY07-12 CIP	**$264**	**$264**	$235	$235	$230	$230	**$1,458**

The February 7, 2006 guidelines apply to FY07, FY08, and the FY07-12 period. The guidelines can be amended by a simple majority of Councilmembers present. The County Code restricts any increase to the first-year or the second-year guideline to 10% over the previously set amount. Since the February 7, 2006 general obligation bond guideline for FY07 was $264 million, the Council cannot raise it higher than $290.4 million. The same is true for the FY08 guideline. The Council can raise or lower the FY07-12 guideline as high or low as it wishes.

As part of the reconciliation required to keep the Approved FY07-12 CIP within the guidelines, in May 2006 the Council agreed to adjust G.O. Bond targets for FYs09-12. The following table shows the final G.O. Bond spending levels for each year of the Approved CIP.

Table 2: General Obligation (G.O.) Bond Spending Levels

in the Approved FY07-12 Capital Improvements Program ($ millions)

	FY07	FY08	FY09	FY10	FY11	FY12	6-Year
FY07-12 CIP	$264	$264	$264	$226	$220	$220	$1,458

In his January 11, 2007 transmittal the Executive noted that his recommended amendments would stay within the guidelines approved last February and the targets used for FYs09-12 in the Approved CIP: in other words, the funding levels shown in Table 2. The G.O. Bond Adjustment Chart reflecting the Executive's recommendations is on ©5. Table 3 displays the Spending Affordability Guidelines and targets in recent CIPs and in the Executive's current recommendations ('FY07-12 Ex'):

A realistic spending pattern. A problem discussed by the MFP Committee this past fall is the Council's recent practice of approving bond level scenarios that are higher in the early years and lower in the later years. This has been done to create more fiscal capacity to fund the schools, roads, parks, college buildings, and other public facilities demanded by the public in the short term, while at the same time staying within a six-year bond limit that appears to grow more modestly. The problem with this practice is that it is unrealistic: only once in the 15-year history of spending affordability have the G.O. Bond guidelines declined from one year to the next, and that was in the early 1990s in response to a recession.

Table 3 shows the G.O. bond guidelines and targets in FYs99-12 for each CIP adopted or amended since 1998. Note that the bond guideline in the actual year (in **bold**) is significantly higher than the earlier projections for that year. This chart doesn't even take into account further perturbations in the actual amounts programmed year-by-year in Approved or Amended CIPs due to the necessities of reconciling the CIP.

Table 3: Affordability Guidelines and Targets in Recent CIPs ($ millions)

CIP	FY99	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
FY99-04	117	119	118	120	120	120								
FY99-04 Am	**123**	**130**	130	120	120	120								
FY01-06			140	140	130	130	129	129						
FY01-06 Am			**154**	**154**	130	130	129	129						
FY03-08					156.2	156.2	142	142	142	142				
FY03-08 Am					**156.2**	**171**	152	142	142	132				
FY05-10							190	190	190	190	190	190		
FY05-10 Am							**209**	**209**	200	200	200	200		
FY07-12									264	264	264	226	220	220
FY07-12 Ex									**264**	264	264	226	220	220

The MFP Committee agreed that a much better practice would be to consider only those scenarios which have the same level of expenditures each year over the six years or those that slowly increase over the six-year period. These would be more accurate—and more honest—depictions of future capital spending. Changing this single practice would mark a vast improvement in evaluating the impact of future debt-based spending. The new scenarios developed for evaluation (in the next section) follow this spending pattern.

Assumptions and inputs. To assist in determining debt capacity—how much debt the County can afford—the Council relies in part on the debt capacity analysis charts that show the value of various indicators of debt affordability at various levels of debt over the next six years. The indicators are:

1. Total debt should not exceed 1.5% of full market value of taxable real property (see Line 2 in the attached Debt Capacity Analysis charts).
2. The sum of debt service and long-term and short-term lease payments should not exceed 10% of the General Fund budget (see Line 3 of the charts).
3. Real debt per capita should not exceed $1,000 by a "significant" amount. As a working definition of this indicator, the Council has assumed that real debt per capita should not exceed $1,600 (see Line 5 of the charts).
4. The ratio of debt to income should not exceed 3.5% (see Line 6 of the charts).
5. 60-75% of the debt at the beginning of any period should be paid off within ten years (see Line 7 of the charts).

All bond scenarios that are evaluated use the same assumptions and inputs for population growth, operating budget growth rate, inflation, growth in assessable base and total personal income, and interest rate on bonds. These assumptions and inputs are prepared by OMB and the Department of Finance. Table 4 is a comparison of the new assumptions and inputs with those they developed a year ago, when the Council last approved guidelines.

Table 4: Debt Capacity Analysis: Key Assumptions and Inputs

	FY07	FY08	FY09	FY10	FY11	FY12
INTEREST RATE ON BONDS						
FY07-12 CIP – January 2006	5.60%	5.60%	5.70%	5.70%	5.70%	5.70%
FY07-12 CIP – January 2007	5.50%	5.90%	5.80%	5.70%	5.70%	5.60%
OPERATING REVENUE GROWTH						
FY07-12 CIP – January 2006	4.80%	4.10%	3.70%	3.50%	3.50%	3.40%
FY07-12 CIP – January 2007		7.70%	4.30%	4.10%	4.30%	4.10%
POPULATION (000)						
FY07-12 CIP – January 2006	964	976	988	1,000	1,008	1,016
FY07-12 CIP – January 2007	964	976	988	1,000	1,008	1,016
INFLATION						
FY07-12 CIP – January 2006	2.60%	2.60%	2.70%	2.70%	2.70%	2.70%
FY07-12 CIP – January 2007	3.50%	2.90%	2.80%	2.70%	2.70%	2.60%
TOTAL ASSESSABLE BASE ($B)						
FY07-12 CIP – January 2006	128.942	147.251	162.675	178.889	196.158	212.492
FY07-12 CIP – January 2007	129.992	146.641	160.446	173.985	191.450	207.553
TOTAL PERSONAL INCOME ($B)						
FY07-12 CIP – January 2006	59.8	62.6	65.3	68.1	71.0	73.9
FY07-12 CIP – January 2007	62.2	65.5	68.3	71.8	75.4	79.1

The notable changes from last year are:

- The interest rate on bonds is marginally lower this fiscal year, but is expected to be slightly higher in FYs08-09.
- The inflation rate is higher in FYs07-09.
- The countywide assessable base is expected to grow a bit less slowly over the next six years.
- The total county personal income, on the other hand, is anticipated to grow a bit faster.
- The operating budget revenue growth is now projected to grow much faster than assumed in FY08, and somewhat faster in FYs09-12. This projection, however, still assumes that the budget will stay within the Charter limit in each of the six years.

These assumptions and inputs drive the results of these indicators more than the difference in the debt levels themselves. Some of the revisions suggest somewhat better economic prospects, some worse. Furthermore, the debt service estimates now are about $5 million/year less than a year ago because a higher amount of debt service was forecasted for the FY06 bond issue than actually occurred. There also are differences in the currently assumed interest rate string for FY07-12 issuances.

The best way to see the effect of these changes is to evaluate the February 2006 guidelines and targets based on OMB's and Finance's assumptions and inputs last year versus their current assumptions and inputs (©6-7). On balance, the indicators are now showing a much better performance. For example: debt as a percentage of the operating budget was 9.20% to 9.99% and rising; now the same scenario shows it going from 8.73% to 8.30% and falling. Debt/capita shows about a 10% improvement. Debt/full value shows a 3-5% improvement. Debt/capita shows a 6-7% improvement.

Scenarios evaluated. Using the new input assumptions, OMB's debt capacity analysis for the spending level in the Approved CIP—which is also recommended by the Executive—is on ©8. At the request of Council staff, OMB produced debt capacity analyses for two other scenarios prior to the MFP Committee's January 29 meeting:

- Keeping the FY07-09 guidelines and targets at $264 million, but raising the FYs10-12 targets to $264 million as well, which would raise the FY07-12 guideline to $1.584 billion, an 8.6% increase over the six-year period (©9). Under this scenario, PAYGO in FYs11-12 would be raised to $26.4 million each year.
- Raising the guidelines and targets in each year to $270 million, which would raise the FY07-12 guideline to $1.620 billion, an 11.1% increase over the six-year period (©10). PAYGO in FY07 and FYs11-12 would be raised to $27.0 million each year.

In aggregate, the debt capacity analyses suggest that there is not a meaningful difference among the three scenarios. In fact, all the scenarios tested have the same results with regard to whether or not they met the indicators the six years of the CIP. Specifically:

1. *Total debt should not exceed 1.5% of full market value of taxable real property:* All scenarios fall well under 1.5% each year, and the 6-year trend for all show continuing improvement.

2. *The sum of debt service and long-term and short-term lease payments should not exceed 10% of the General Fund budget:* All scenarios fall under 9% every year (except in FY08) and the 6-year trend for all show continuing improvement.
3. *Real debt per capita should not exceed $1,600:* All scenarios exceed $1,600 in every year, and the 6-year trend for all show real debt/capita rising more quickly.
4. *The ratio of debt to income should not exceed 3.5%:* All scenarios fall well under 3.5% in every year. The current (Executive's) scenario shows debt/income dropping over the 6-year period; the two higher scenarios show debt/income rising, but at a slow rate and still well below 3.0% by FY12. The rise in the income projection is more significant that an increase in bond levels. For example, last year's analysis of the current scenario showed debt/income to be higher than 3.0% in FYs08-12.
5. *60-75% of the debt at the beginning of any period should be paid off within ten years:* All scenarios fall within this range every year. The trend for all three is slightly negative, but in each case the payout ratio is less than 70%.

The finding that the performance of one scenario differs little from another is not unexpected, since most debt is paid from previous issues. Ultimately, the decision about how much debt to issue should be based on the County's long-term (20-year) economic prospects, not on shorter-term fluctuations.

Council staff recommendation: Raise the FY07 and FY08 guidelines to $270 million and the FYs09-12 targets to $270 million as well, thus raising the six-year guideline to $1.620 billion, an 11.1% increase (©10). The debt indicators show that such an increase can readily be absorbed, even if the trends were extrapolated well beyond FY12. This recommendation represents a modest 2.3% increase in FYs07-09; the additional revenue will be needed to help offset the sizable expected shortfall in school and transportation impact tax and recordation tax revenue. The biggest proposed increase is in FYs10-12 when, as history would suggest, the bond levels will be at least as high as $270 million. Much of this latter increase is needed to offset the larger impact tax and recordation tax revenue deficits likely in those years.

MFP Committee recommendation (3-0): Retain the FY07 and FY08 G.O. Bond guidelines and the FY09 G.O. Bond target at $264 million each year; raise the FYs10-12 G.O. Bond targets to $270 million/year, raising the FY07-12 G.O. Bond guideline to $1.602 billion, a 9.9% increase (©11). The Committee does not wish to raise the levels in the first three years but recognizes the long-term programming trends and is willing to show spending growth in the last three years.

Subsequent to the Committee's worksession, other Councilmembers requested a few additional scenarios be evaluated:

- Raising the guidelines and targets in each year to $275 million, which would raise the FY07-12 guideline to $1.650 billion, a 13.2% increase over the six-year period (©12). PAYGO in FY07 and FYs11-12 would be raised to $27.0 million each year.

- Raising the guidelines and targets in each year to $280 million, which would raise the FY07-12 guideline to $1.680 billion, a 15.2% increase over the six-year period (©13). PAYGO in FY07 and FYs11-12 would be raised to $28.0 million each year.
- Raising the guidelines and targets in each year to $290 million, which would raise the FY07-12 guideline to $1.740 billion, a 19.3% increase over the six-year period (©14). PAYGO in FY07 and FYs11-12 would be raised to $29.0 million each year.

Councilmembers Ervin, Floreen, Knapp and Leventhal are proposing an alternative scenario:

- **Raising the FY07 guideline to $275 million, and raising the FY08 guideline and FY09-12 targets in each year to $280 million, which would raise the FY07-12 guideline to $1.675 billion, a 14.9% increase over the six-year period. PAYGO in would be raised to $27.5 million in FY07 and to $28.0 million in FYs11-12.**

The results of a debt capacity analysis for this scenario would be virtually the same (very marginally better) than the $280 million/year scenario evaluated on ©13. Under this scenario:

- Debt/assessed value is much better than the 1.5% standard each year, and continues to improve over time, although the improvement is not quite as good as for MFP's or Council staff's recommendations.
- Debt + lease payments/General Fund operating revenue is better than 10.0% (actually better than 9.5%) each year, although it continues to weaken over time.
- Real debt/capita fails the $1,600 standard each year (as does the other scenarios) and grows worse over time, reaching about $1,900 in FY12, compared to $1,861 under MFP's proposal.
- Debt/total income is much better than the 3.5% standard each year, and remains stable at around 2.90% over time; MFP's proposal is in the 2.83-2.85% range.
- The payout ratio remains well within the 60-75% range.

2. Implementation rates. The implementation rate for a given year is the total amount of spending in that year divided by the amount of expenditures initially programmed for that year. An implementation rate is actually a mixture of three factors: the degree to which programmed expenditures in a year are actually spent in that year; the degree to which programmed expenditures from a previous year are lapsed into a subsequent year; and the degree to which the Council approves supplemental and special appropriations which result in additional spending. The implementation rate allows the Council to 'overbook' the CIP to some degree, knowing that not all the funds programmed will be actually spent.

Council staff has asked OMB to calculate the implementation rate for each agency for the last full fiscal year for General Obligation Bond proceeds, and to array these rates against those of the prior four years. The calculations are on ©15. A summary is displayed below:

<u>Table 5</u>: Implementation Rates by Program and Year for G.O. Bond Funds

	FY02	FY03	FY04	FY05	FY06	5-yr Avg
MCPS	123%	71%	100%	66%	125%	**97%**
Mont. College	68%	171%	112%	132%	75%	**112%**
Parks	64%	110%	131%	82%	56%	**89%**
Transportation	94%	76%	115%	80%	87%	**90%**
MCG-Other	21%	158%	58%	55%	95%	**77%**
TOTAL	**87%**	**95%**	**91%**	**70%**	**104%**	**90%**

The average implementation rate in FY06 across all agencies for bond-funded projects was 103.86%. However, since rates fluctuate widely from one year to the next strictly due to the experience on a few large projects or even based on when bills happen to be paid, the best indicator for the future forecast of implementation rates is a multi-year average, not the rate from a particular year. As is noted on ©15, the average implementation rate across agencies over the past five years has been 89.53%. The Executive is recommending continuing the implementation rate assumption of 92% for each year during the CIP period.

MFP Committee *(and Council staff)* **recommendation (3-0): Set the implementation rate at 90% for each year.** This is a more accurate representation of implementation over the past five years.

3. Inflation rates. The inflation rates in the adjustment charts are not supposed to measure construction cost inflation, but general inflation: they are a means of translating the general value of the annual bond issue targets so that they can be compared against aggregate CIP expenditures, which are expressed in constant dollars. The Department of Finance takes the lead in developing inflation forecasts.

Typically a forecast is developed during the fall which is part of the basis for building the Executive's Recommended CIP. The set of inflation assumptions developed for these amendments is almost the same each year compared to the rates assumed in the Adopted CIP. The exceptions: the suggested inflation rate is now 0.1% higher for FY09 and 0.1 lower for FY12. The Department of Finance typically updates these assumptions during the winter based on more recent trends, in preparation for the development of the Executive's Recommended Operating Budget and Public Services Program (PSP). Typically the Council uses the same rates in the CIP as in the PSP. When the updated rates are available Council staff will report their effect on the funds available for programming.

Table 6 shows the inflation assumptions used in the recently approved CIPs and the rates used for the Executive's recommendations for the amended CIP ('FY 07-12 Exec') in **bold type**:

Table 6: Inflation Assumptions in Recent CIPs (%)

CIP	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12

FY03-08	2.50	2.50	2.60	2.60	2.60	2.50				
FY03-08 Am	2.30	2.40	2.40	2.30	2.40	2.30				
FY05-10			2.40	2.30	2.40	2.50	2.40	2.30		
FY05-10 Am			2.80	2.60	2.60	2.60	2.50	2.50		
FY07-12					2.60	2.60	2.70	2.70	2.70	2.70
FY07-12 Exec					**2.60**	**2.60**	**2.80**	**2.70**	**2.70**	**2.60**

MFP Committee *(and Council staff)* **recommendation (3-0): Use the Executive's recommended inflation rates for now.**

4. 'Regular' PAYGO. Typically the CIP dedicates a certain amount of current revenue as an offset against bond expenditures, also called PAYGO. The Executive recommends no change to the PAYGO assumptions adopted by the Council last spring. The PAYGO assumptions in recent CIPs are in Table 7; the Executive's recommendations for the amended CIP are in **bold type**:

Table 7: 'Regular' PAYGO Assumptions in Recent CIPs ($ millions)

CIP	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	6-Yr
FY01-06	82.5	65.0	46.0	30.0	30.0	30.0							283.5
FY01-06 Am	40.7	61.8	44.5	34.5	30.0	30.0							241.5
FY03-08			18.0	34.5	38.0	30.0	30.0	22.0					172.5
FY03-08 Am			7.3	5.1	41.0	28.6	25.0	22.0					129.0
FY05-10					13.0	36.0	36.0	38.0	38.0	39.6			200.6
FY05-10 Am					7.3	11.7	36.0	38.0	38.0	39.6			170.6
FY07-12							26.4	41.4	44.0	33.0	22.0	22.0	188.8
FY07-12 Exec							**26.4**	**41.4**	**44.0**	**33.0**	**22.0**	**22.0**	**188.8**

A policy adopted by the Council and Executive is that, in every year, the County should program a PAYGO amount equal to at least 10% of each G.O. Bond guideline and target. *Therefore, Council staff recommends increasing the PAYGO in FY07, FY11, and FY12 to $27 million/year.*

MFP Committee recommendation (3-0): Use last year's PAYGO assumptions (same as the Executive's recommendation) **for FYs07-10, but raise both the FY11 and FY12 PAYGO levels to $27 million in accordance with the 10% policy.** The level of PAYGO is FY07 and FY08 may be revisited after the Executive's Recommended FY08 Operating Budget is released in March.

In concert with their recommendation for the G.O. Bond spending affordability guidelines, Councilmembers Ervin, Floreen, Knapp and Leventhal recommend raising PAYGO to $27.5 million in FY07 and to $28.0 million in FYs11-12, in accordance with the 10% policy.

5. Recordation tax revenue. In 2002 the Council approved an increase to the County's recordation tax. The proceeds of this increment are to be used to supplement capital funding for MCPS project's and Montgomery College's Information Technology project. These funds appear as a type of Current Revenue, but are separate from the 'regular' Current Revenue discussed later.

Revenue from the Recordation Tax increment has risen steadily since it was first introduced: from $23.2 million in FY03 to $33.9 million in FY04, $39.7 million in FY05, and $44.9 million in FY06. The Council has been regularly advised as to the volatility of Recordation Tax revenue, so in September 2005 it settled on an assumption of $35 million annually. In November 2005, however, the Department of Finance recommended a higher string of estimates, based on the facts that revenue in FY06 was climbing faster than had been estimated, and that—even with a potential downturn in the number of home sales and refinancings—housing prices would likely increase. Therefore, at that time the Executive recommended an estimate of $41.5 million in FY07 rising to $48.1 million in FY12, and the Council concurred.

Table 8: 'Recordation Tax' Revenue Assumptions ($ millions)

CIP	FY07	FY08	FY09	FY10	FY11	FY12	6-Yr
Council (Sept. '05)	35.0	35.0	35.0	35.0	35.0	35.0	210.0
Exec (Jan. '06)	41.5	41.3	42.6	44.0	45.7	48.1	263.2
FY07-12 Exec	**41.5**	**41.3**	**42.6**	**44.0**	**45.7**	**48.1**	**263.2**

The Executive did not recommend changing these assumptions in his January 11 transmittal. However, during the half of FY07, revenue from the Recordation Tax increment has fallen substantially: only $16,144,614 has been collected. At the current pace, the shortfall in FY07 will be about $9 million, with significant doubt cast on the present revenue assumptions for FYs08-12.

Council staff recommendation: Return to the $35 million/year projection the Council had set in September 2005. Even this may be a bit too generous an assumption for FY07, but it represents the average annual collection over the past 4 years. Recognize, however, that this creates a revenue hole in the CIP of $6.5 million in FY07, $6.3 million in FY08, and $53.2 million over the 6-year period.

MFP Committee recommendation (3-0): Concur with Council staff, except to assume only $32 million for FY07. The Committee believes that collections in the second half of this fiscal year may be no larger than those in the first half.

6. School Impact Tax. In late 2003 the Council initiated a countywide development impact tax to fund school construction projects that add capacity. The law went into effect on March 1, 2004; any permits for new units for which the application was made after February 29, 2004 was subject to the tax, except for those units that are exempt (affordable housing and all housing within enterprise zones).

The initial assumptions forecasted that there would be little tax revenue during the last four months of FY04, predicting a rush of permit applications to beat the March 1 effective date.

However, it was not predicted that this would produce significantly less revenue by FY05. The CIP assumed $24 million in revenue from this tax in FY05, with $28 million in later years.

Only $7.7 million was collected in FY05, and only $7.0 million was collected in FY06. The initial revenue estimates were wrong for several reasons:

- The pre-March 1 permit rush had effects lasting well into FY05, as developers were successful in having their pre-March permit applications extended beyond the normal 6-month period. DPS estimates that about 1,700 permits approved in FY05 were grandfathered. This was a short-term phenomenon, of course, and did not extend into FY06.
- Single-family units—which pay the highest tax—comprised a much smaller proportion of the units permitted: in FY05, 37% of all units, and 34% of the units for which the tax was paid, both far less than the 70% that was assumed.
- Garden apartments—which paid $4,000/unit—comprised a much smaller proportion of the multi-family units permitted: in FY05 it was 6%, far less than the 53% initially assumed. The balance of multi-family units permitted were high-rise units, which paid $1,600/unit.
- About 23% of all units in FY05 were exempt from the tax compared to the 17% expected to be exempt.

In FY06 these trends continued, together with a downturn in housing starts, resulting in a further drop to only about $7.0 million in school impact tax revenue for the year.

The Council adjusted down the revenue estimates in the fall of 2005 based on these trends, but it revised them up again last winter. It opted to use the Department of Finance's (Executive's) forecast instead of Council's staff's slightly lower projection (see Table 9).

Table 9: School Impact Tax Revenue Estimates ($ millions)

Assumption (Date)	FY07	FY08	FY09	FY10	FY11	FY12	6-Yr
Bill 9-03 (Fall '03)	28	28	28	28	28	28	168
Council (Sept. '05)	8	8	8	8	8	8	48
Exec (Jan. '06)	15	18	20	23	25	27	128
Council staff (Jan. '06)	*14*	*16*	*17*	*20*	*20*	*21*	*108*
FY07-12 Assumption	**15**	**18**	**20**	**23**	**25**	**27**	**128**

As with the Recordation Tax increment, the Executive has not recommended revising the revenue projection. And, as with the Recordation Tax increment, school impact tax revenue is falling well below the projection. Through the first half of FY07 the County has collected only $4,078,793 in school impact tax revenue, extrapolating to only about $8 million in FY07 and also casting doubt on the assumptions for FYs08-12.

MFP Committee *(and Council staff)* **recommendation (3-0): Return to the $8 million/year assumption the Council had set in September 2005.** With 2½ year's worth of experience with this tax, it appears that about $8 million is a fairly stable assumption.

Recognize, however, that this creates a hole of $7 million in FY07, $10 million in FY08, and $80 million over the 6-year period.

7. Transportation Impact Tax. The County assessed transportation impact taxes (initially, impact *fees*) since 1986, but they have been applied countywide only since 2002. In late 2003 the Council passed Bill 31-03, raising the rates for the transportation impact tax, which also went in effect on March 1, 2004.

The estimates associated with Bill 31-03 assumed between $7-8 million in revenue during FYs07-08, partly because of the anticipated rush to apply for building permits, and partly because of the expected draw down of credits. The latter is the aspect of the transportation impact tax that makes it the most difficult of these development-related revenue sources to predict. Developers receive a dollar-for-dollar credit against the impact tax for County transportation capacity that they provide as a condition of their developments' approvals. There is no accurate means of predicting when and how much of the millions of dollars of outstanding credit will be drawn down. Although the Council tightened the credit provisions in 2003, the tightening applied only to new agreements, and was not applied retroactively. The actual collection of impact tax revenue in FY05 was about $8.5 million, $1.4 million above the estimate. However, collections in FY06 dropped to about $6.3 million, $0.7 million below the projection.

For the out-years, Bill 31-03 assumed $12.5 million/year in FYs07-08 and $18.5 million/year in FYs09-10. The rationale was that the building permit rush would be over before FY07 and, as time went on, the tighter credit provisions would produce less of a dampening effect on receipts. The transportation impact tax also has a built-in biennial inflation increase.

In September 2005 the Council decided to assume $8 million annually from this tax, primarily based on the funds that had been received in FY05 and the unpredictability of credit draw-downs. (Credit is possible—but rare—against the School Impact Tax, and so it is not an important factor in predicting its revenue.) Later that fall, however, the Department of Finance generated a higher forecast, with future receipts ranging up from about $10 million in FY07 to $23.7 million in FY12, which the Council ultimately accepted for the FY07-12 CIP. The various estimates that have been developed are displayed in Table 10 below:

Table 10: Transportation Impact Tax Revenue Estimates ($ millions)

Assumption (Date)	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	6-Yr
Bill 31-03 (Fall '03)	7.1	7.6	12.5	12.5	18.5	18.5			76.7
FY05-10 Am	7.1	7.7	12.5	12.5	19.0	19.0			77.8
Council (Sept. '05)			8.0	8.0	8.0	8.0	8.0	8.0	48.0
Finance (Fall '05)			10.0	13.9	14.5	19.4	20.9	23.7	102.4
FY07-12 Assumption			**10.0**	**13.9**	**14.5**	**19.4**	**20.9**	**23.7**	**102.4**

Council staff recommendation: Return to the $8 million/year assumption the Council had set in September 2005. This will continue to be a particularly volatile revenue source due to the outstanding credits. The Executive Branch has consistently made a large point about how both transportation and school impact tax revenue have not covered their respective budgeted expenses, requiring large General Fund advances. The Council should do all it can to avoid a repeat of this past experience. It can do so by programming these funds conservatively. Recognize, however, that assuming $8 million annually for the transportation impact tax creates a hole of $2 million in FY07, $5.9 million in FY08, and $54.4 million over the 6-year period.

MFP Committee recommendation (3-0): Assume $8 million in revenue for FY07 and $10 million/year for FYs08-12. The Committee believes there would be a modest increase starting in FY08, but still well below the assumptions in the Approved CIP.

8. Set-aside for bond-funded projects. In building the CIP the Executive has always set aside some funding capacity to cover anticipated and unanticipated contingencies. The set-asides in prior CIPs are shown in Table 11, and the Executive's latest recommendations are in **bold type**:

Table 11: Capital Set-Asides for General Obligation Bonds in Recent CIPs ($ millions)

CIP	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	6-Yr	%
FY03-08	9.1	13.0	19.3	23.3	46.7	84.1					195.5	16.9
FY03-08 Am	0.7	6.3	11.4	15.5	26.6	52.0					112.5	10.0
FY05-10			7.8	10.5	13.5	25.0	33.9	41.5			132.2	9.0
FY05-10 Am			2.0	11.3	10.9	18.9	28.3	60.1			131.6	-0.5
FY07-12					9.2	14.4	16.1	38.3	87.0	104.3	269.2	104.6
FY07-12 Rec					**7.0**	**8.1**	**12.1**	**16.0**	**84.0**	**105.1**	**232.3**	**-13.7**

Council staff is concerned about the small set-aside in FYs09-10. The set-asides will be needed for: (1) the design, land acquisition, and construction cost of projects currently in facility planning, whether they be roads, schools, or anything else; (2) the inevitable cost increases that occur once more is known about the scope of projects and the problems that must be overcome to deliver them; and (3) the one-time needs or opportunities that cannot be foreseen.

9. State school construction aid. The Executive has recommended continuing the State aid assumption in the Approved CIP of $40 million annually throughout the balance of the CIP period. In his proposed FY08 Capital Budget Governor O'Malley proposes $400 million in State aid for school construction statewide. So far, he has allocated $29,311,000 for school projects in Montgomery County, or about 12% of the funds that he assigned. However, if his full budget is approved by the General Assembly, another $157,850,000 will be allocated in late April/early May by the Board of Public Works. If the County were allocated the same 12% of this balance, the County will receive about $50 million for FY08.

Council staff recommendation: Starting in FY08, assume $50 million annually for State school construction aid. The County certainly will have at least this much eligible for State aid in each of the next several years; the FY08 request, for example, is $135.5 million. The question is whether the State can sustain a program large enough to fund $50 million annually.

MFP Committee recommendation (3-0): Retain the current assumption of $40 million annually. This early in the State's budget deliberations the Committee does not want to plan on receiving more than $40 million in FY08. Even if $50 million mark is ultimately attained in FY08, however, the Committee does not believe that the State's longer term budget prospects should allow for more than $40 million in construction aid for County schools.

II. CURRENT REVENUE

The Executive's proposed Current Revenue Adjustment Chart is on ©16. The Executive is recommending that about $207.4 million of tax supported Current Revenue be available in FY07-12, about $4.9 million more than in the Approved CIP: he recognizes the allocation about $5.6 million more in FY07, $0.7 million less in FY08, and the same amounts in later years. Current Revenue levels in past CIPs and in the Recommended CIP are shown in Table 12:

Table 12: Current Revenue in Recent CIPs ($ millions)

CIP	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	6-Yr
FY03-08	20.0	26.6	26.6	25.7	14.9	14.9					129.4
FY03-08 Am	20.0	26.6	25.9	24.4	13.8	14.1					124.8
FY05-10			23.7	28.9	14.6	16.7	11.5	10.5			105.9
FY05-10 Am			23.7	9.3	14.6	16.7	11.5	10.5			86.2
FY07-12					35.0	52.7	33.5	30.8	25.3	25.3	202.5
FY07-12 Rec					**40.6**	**52.0**	**33.5**	**30.8**	**25.3**	**25.3**	**207.4**

The inflation rates are the same as those recommended for General Obligation Bonds and Park and Planning Bonds. The implementation rates for Current Revenue have always been assumed to be 100%; all Current Revenue in the Operating Budget is assumed to be fully spent.

MFP Committee *(and Council staff)* **recommendation (3-0): Concur with the Executive's assumptions on Current Revenue in the CIP for now.** Like for PAYGO, however, the FY07 and FY08 Current Revenue levels may be revisited after the Executive's Recommended FY08 Operating Budget is released in March.

III. PARK AND PLANNING BONDS

On February 7, 2006 the Council approved Spending Affordability Guidelines for Park and Planning Bonds of $3.5 million for FY07, $4.0 million for FY08, and $23.5 million for FY07-12. (The targets in FYs09-12 are $4.0 million each year.) In his January 11 submission the Executive recommended spending consistent with the existing guidelines and using the new inflation rates now proposed for G.O. Bonds and Current Revenue (©17). His set-aside of about $5.0 million comprises about 19.2% of the funds available for projects, which is an appropriately higher percentage for this relatively small capital program. He is assuming an implementation rate of 87% for each year, the same rate assumed in the CIP approved last spring.

MFP Committee *(and Council staff)* **recommendation (3-0): Retain the guidelines and targets for Park and Planning Bonds.**

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